# EXHIBIT W

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| **From:** | Scott Davis <ScottD@filsingerEnergy.com> |
| **To:** | José F. Ortiz Vázquez |
| **CC:** | Todd Filsinger |
| **Sent:** | 7/25/2019 3:07:27 PM |
| **Subject:** | RSA Headroom Discussion |

Mr. Ortiz,

Please find attached a draft presentation providing an overview as a follow-up to previous conversations with Todd regarding the ability to absorb the RSA under base rates. It summarizes head room from a cash flow perspective looking at FY2019 actuals projected into FY2020, as well as from a budgeted revenue requirements perspective looking forward for several years.

Please let Todd or me know if you have any questions or redirects regarding RSA issues.

Best regards,

Scott

ScottD@FilsingerEnergy.com
THE BUSINESS, THE SCIENCE, THE EXPERTS - IN ENERGY

Puerto Rico
Electric Power
Authority

# Puerto Rico Electric Power Authority

## Revenue Allocation Overview
## FY's 2019 & 2020

June 30, 2019

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## Executive Summary

**Situation**

- Restructuring Service Agreement (RSA) with Creditors requires 25+ years of Securitization Charges
  - FY2020 Settlement Charge (SC) of 1.000c/kWh; ~$160M on ~16TWh of sales
  - FY2021 begins Transition Charge of 2.768c/kWh growing to 4.552c/kWh; generally maintains an average of $390M/year of debt service payments given the IRP consumption forecast


**Questions**

- Under the current rate structure, does the flexibility exist to absorb the RSA Securitization Charges
- How much will IRP and operating efficiency improvements offset the RSA Securitization Charges

**Findings**

- FY2019 cash flows suggest there may be headroom to absorb RSA Securitization Charges
- FY2020 budgeted all-in rates with the SC are flat to FY2019, but FY2021 increases $3.1c/kWh
  - Lower production expenses are offsetting the FY2020 RSA charges
- However, forecast cost structure, if executed, leaves little flexibility to reduce near term base rates

**Fuel and Purchased Power expense savings is the primary vehicle for offsetting RSA costs**





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## FY2019 Cash Flow Sources & Uses*

| 52 Week Cash Flow Summary From: 6/29/2018 To: 6/21/2019 | Ordinary Operations of PREPA | Title III | Emergency & Insurance | Debt Service | Totals, $M |
|---|---|---|---|---|---|
| **Initial Operating Fund Cash Balance** | | | | | **191.7** |
| **Sources** | | | | | |
| Customer Receipts | 3,300.9 | | | | 3,300.9 |
| Other Receipts | 15.6 | | | | 15.6 |
| FEMA Reimburements | | | 777.6 | | 777.6 |
| Insurance Proceeds | | | - | | - |
| Commonwealth Loan | | | | 149.1 | 149.1 |
| **Total Sources** | **3,316.6** | **-** | **777.6** | **149.1** | **4,243.3** |
| **Uses** | | | | | |
| Energy Purchases | (2,062.9) | | | | (2,062.9) |
| Ordinary Operations Expense | (820.7) | | | | (820.7) |
| Contract Labor - Title III | | (56.6) | | | (56.6) |
| Emergency & Insurance | | | (893.1) | | (893.1) |
| Debt Service | | | | (309.1) | (309.1) |
| **Total Uses** | **(2,883.6)** | **(56.6)** | **(893.1)** | **(309.1)** | **(4,142.3)** |
| **Net Sources & Uses** | **432.9** | **-56.6** | **-115.4** | **-159.9** | **101.0** |
| **Ending Operating Fund Cash Balance** | | | | | **292.7** |

- Net cash flow from PREPA operations of $433M was used to fund Title III expenses ($57M), unreimbursed emergency expenditures ($115M), and net debt service associated with retirement of the Commonwealth Loan ($160M)
  - This view may be misleading as cash expenses may not reflect current accrued liabilities
  - Per the April Interim Report, accounts payable has increased ~$357M since the beginning of the fiscal year

*Cash flow summary from available data; begins the last week of FY2018 and runs through the week before FY2019 end.



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## Looking Ahead to FY2020 & FY2021 Cash Flows

**Let's Assume…**

- PREPA cash flow operations run rates remains consistent with FY2019 but for any budgeted additions
  - Generally flat to budget for labor expense
  - Continue under spending of non-labor and maintenance budgets
- Full reimbursement of emergency and permanent works expenses, excluding required PREPA cost shares, with no additional working capital outlays to fund work prior to reimbursements
- No debt service expense outside of the RSA (Commonwealth Loan has been paid off)
- No payout for incremental Accounts Payable
  - Incremental $357M of current A/P reported in April Interim Report relative to start of the FY
  - Unknown at this time whether May and June cash flows have materially affected the current A/P balance

| A View of Estimated Net Cash Position* | FY2020 | FY2021 |
|---|---|---|
| FY Starting Operating Funds Balance | 293 | 575 |
| PREPA FY2019 Run Rate Net Cash Flow | 433 | 433 |
| Reimbursement of Oustanding FEMA exp | 115 | - |
| Incremental O&M Expense | (94) | (77) |
| Incremental Title III, FOMB, & P3A Expense | (20) | 81 |
| Other (bad debt, other revenue, interest) | 6 | 9 |
| **Net Run Rate Cash Flow Forecast** | **440** | **447** |
| Securitization Charge - RSA Amounts | (158) | (409) |
| Securitization Charge - ERS Amounts** | - | (228) |
| **Cash Flow After Securitization Charges** | **282** | **(191)** |
| FY Ending Operating Funds Balance | 575 | 384 |

**FY2019 operating cash flows projected forward suggest potential for funding Securitization Charges from Base Rates**

*Does not consider the $357M of increased FY2019 A/P balance.
**Retiree benefits expense moves from O&M to a Securitized Charge in FY2021.



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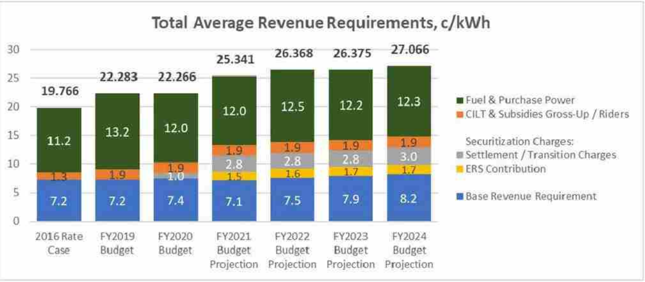
# Overview of Budgeted Rates Requirements

- At right, average rates by revenue component from the 2016 rate case to FOMB approved budgets for FY's 2019 & 2020, as well as the latest FOMB budget projections for FY's 2021-2024
- All non-pass-through expense budgets (i.e., Base Revenue Requirement) are constructed to balance against expected Base Rate revenues at the current permanent rates
- Fuel & purchased power expenses reflect IRP submission (per Planning)




- FY2020 budgeted all-in rate is flat to FY2019 despite initiation of the Settlement Charge
  - Fuel & purchased power expense reduction of 1.2c/kWh is offsetting a 0.2c/kWh increase in budgeted operating and necessary maintenance costs (Base Revenue Requirement) plus 1.0c/kWh of securitization charges
- FY2021 budget shows an all-In rate increase of 3.1c/kWh
  - ~1.8c/kWh as the RSA Settlement Charge is replaced with the RSA Transition Charge
  - ~1.0c/kWh due to ERS contribution becoming a securitized charge beginning in FY2021
    - FY2020 budgeted retirement benefits of ~$83M, equivalent to ~0.5c/kWh within the Base Revenue Requirement
    - Increases to ~$228M (~1.5c/kWh) for FY2021 as ERS contribution becomes actuarially determined
  - ~0.2c/kWh increase in Base Revenue Requirement, net of the 0.5c/kWh ERS cost shift to the Securitization Charges

**Production cost reductions are offsetting Settlement Charges in FY2020; However, Transition Charges net of budget adjustments add 3.1c/kWh in FY2021**

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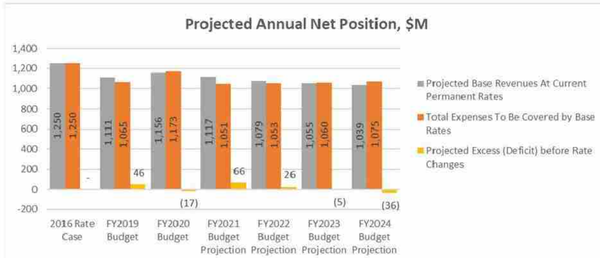
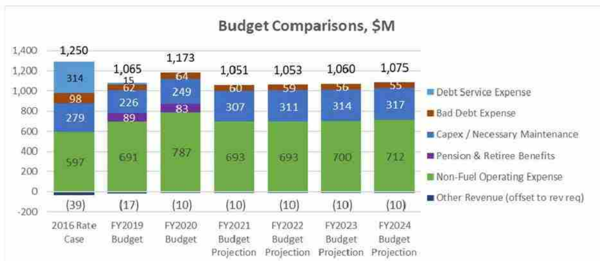
## Budgeted Base Revenues & Expenses




**Projected Annual Net Position**

- 2016 Rate Case set base rates such that revenues matched the PREB approved budget in 2016
- All budgets since the rate case are generally balanced against expected base revenues at the permanent rates
  - Declining revenues (and budgets) are due to falling consumption forecasts

**Budget Comparisons**

- Structural change: pension and retiree benefits will be moved from non-fuel operating expense (broken out for FY2019 & FY2020) to be included in the Securitization Charge beginning with FY2021
- Material budget moves since the 2016 rate case

| Reconcile Allowed Revenue Requirements to Budgets | FY2019 Budget | FY2020 Budget | FY2021 Budget Projection |
|---|---|---|---|
| Base Revenue Impact of Reduced Consumption & Sales | (139) | (94) | (134) |
| Change In Budgeted Expenses | | | |
| Lower Debt Service Expense | 299 | 314 | 314 |
| Lower Bad Debt Expense | 37 | 35 | 38 |
| Change in Capex / Maintenance Expense | 54 | 30 | (28) |
| Change in Other Revenue | (22) | (29) | (29) |
| Higher Non-Fuel Operations Costs | (81) | (152) | (76) |
| Title III, FOMB & P3A Expenses | (101) | (121) | (20) |
| **Budgeted Net Position Relative to 2016 Rev Req, $M** | **46** | **(17)** | 66 |

**Budgets suggest PREPA requires 100% of base rate revenues to fund O&M. But will PREPA spend the money?**



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# Estimated O&M Run-Rate Review*

**Operations & Maintenance Expenses by Division (inclusive of labor expense)**

- Run-rate based on annualizing April YTD*
- Projected operations expenses are under budget by ~$156M (20%)
  - The maintenance category of operating expense presumably covers generation and T&D; combined projected G,T&D spending is ~$39.5M under budget
- Projected Maintenance Projects expenditures are $105M under budget
- Caveat: the projected run-rate underspend through April could be substantially reduced by accelerated spending in May and June

| Operations & Maintenance Expenses by Division<br>*$ thousands (unless specified otherwise)* | FY2019 Budget* | FY to Date April 2019<br>FYTD April 2019 Budget | FYTD April 2019 Actual | FY2019 10A+2E | FY2019 10A+2E Estimated Under/(Over) Budget | |
|---|---|---|---|---|---|---|
| | | Per April 2019 Interim Report, pg 19... | | | | |
| Generation / Other Production | 51,684 | 43,070 | 42,060 | 50,472 | 1,212 | 2% |
| Transmission & Distribution | 119,825 | 99,854 | 104,351 | 125,221 | (5,396) | -5% |
| Maintenance | 187,801 | 156,501 | 120,122 | 144,146 | 43,655 | 23% |
| Customer accounting & collection | 103,964 | 86,637 | 67,565 | 81,078 | 22,886 | 22% |
| Administrative and general | 215,371 | 263,941 | 185,569 | 222,683 | 94,046 | 44% |
| Title III, FOMB & P3A | 101,358 | | | | | |
| **TOTAL Non-Fuel Operating Expense** | **780,004** | **650,003** | **519,667** | **623,600** | **156,403** | **20%** |
| Transmission & Distribution | 111,765 | 70,160 | 56,526 | 67,831 | 43,933 | 39% |
| Generation | 95,615 | 74,380 | 41,523 | 49,828 | 45,787 | 48% |
| Other | | 37,470 | 2,394 | 2,873 | 15,362 | 84% |
| Executive (General & Admin) | 14,550 | | | | | |
| Customer Service | 3,060 | | | | | |
| Planning and Environmental Protection | 2,500 | | | | | |
| Labor Reform | (1,875) | | | | | |
| Federal Funding Cost Share | | | | | | |
| **Total Maintenance Projects** | **225,614** | **182,010** | **100,443** | **120,532** | **105,083** | **47%** |
| **Total Operations & Maintenance Spend** | **1,005,618** | **832,013** | **620,110** | **744,132** | **261,486** | **26%** |

*FY2019 operating budget by division is estimated from the April 2019 Interim Report assuming reported budget amounts are distributed monthly on a pro rata basis

**Summary: ~$260M Under Spending of FY2019 Budget**

- No Division appears to be on track to spend budgeted amounts for utility operations or maintenance projects in FY2019
- Since overall labor expenses appear to be reasonably on budget, overall underspend is in materials and supplies and professional services
  - Salaries and wages were flat to budget through April, overtime was over budget by ~$11M while benefits were under budget by ~$3M, net ~$8M over budget (relatively small compared to the total under spend)
- Is the problem with procurement, project management, management discretion, other factors, or some combination?

**Will PREPA continue to materially out perform (under spend) budgets?**

*Run-rate analyses use year-to-date amounts reported in the Interim Report and 725 Reports for April 2019, grossed up to estimate full fiscal year amounts.



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## Recap & Considerations

- Securitization charges begin in July 2019 and continue for 25+ years
  - FY2020: RSA 1.0c/kWh; ~$160M
  - FY2021: RSA 2.768 + ERS 1.547 = 4.315c/kWh; RSA ~$409 + ERS ~$228 = ~$637M
- Projected budgeted all-in rates are flat from FY2019 to FY2020; however, FY2021 increase of $3.1c/kWh primarily due to increased Securitization Charges
  - Certified FOMB fiscal plans match expenses to expected revenues, which are falling with consumption forecasts
  - Includes costs and benefits of certain improvement initiatives
  - Fuel and purchased power expenses are consistent with the IRP
    - However, benefit of SJ5&6 fuel conversion, estimated at ~$124M/year (~0.8c/kWh) in savings, is not included
- Budgeted, controllable non-fuel O&M costs are up $122M for FY2020 relative to the 2016 rate case
- However, run-rate analyses for FY2019 suggest PREPA is materially under spending budgeted expenses
  - Net operating cash flow for FY2019 before debt service and extraordinary items of ~$433M
  - Recorded expenses versus budgets through April, annualized, suggest an under spend of ~$260M
  - Need additional data (i.e., May and June accounting) to narrow the budget to actuals analysis
- This analysis does not address the following questions
  - Quality of the budgets; that is, are budgets accurately reflecting required expenditures?
  - Causation of the underspend

**What is the case for Not spending budgeted funds?**

*FY2019 run-rate expenses analyses uses YTD amounts reported in the Interim Report and 725 Reports for April 2019, grossed up to estimate full fiscal year amounts.



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## The Way Forward

**Methods of Effecting Consumer Rates**

- Changes in pass-through fuel and purchased power expense are effective at each quarterly update, so are thus immediately effective
- Non-pass through costs require a formal PREB proceeding for approved rates to be changed
- No explicitly called for rate cases with the PREB [per FEP's knowledge]
  - However, expect PREB will have to certify Securitization Charges before such can go into effect, which may trigger a PREB inquiry or order for cost review
  - Also, it's been over 3 years and material changes to PREPA since the last rate case; expect PREB to initiate a proceeding [soon?] regardless of the RSA and Securitization Charges issues
  - PREPA could initiate a revenue requirements / rate review to effectuate a desired rate change

**Planning**

- Focus since Title III and the hurricanes has been to identify and remedy structural, operational, and infrastructure concerns at the fastest possible pace
- PREPA's under spend of operating and necessary maintenance budgets may be a symptom of a lack of tactical planning regarding availability of resources, both human and capital, which may or may not be rectified in FY2020
- A thorough analysis of revenue requirements considering available or acquirable resources and achievable allocation of resources to properly sequenced initiatives may provide the beneficial effect of lowering near-term budgets and enable lower revenue requirements and associated rates
- In any event, a thorough review of revenue requirements should be undertaken to prepare for the next rate case





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